

DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

I. D. #5760

RESOLUTION E-4002

DATE: July 20, 2006

R E S O L U T I O N

Resolution E-4002: Pacific Gas and Electric (PG&E) requests approval of a tolling agreement between itself and Duke Energy Marketing America (DEMA) for electricity and capacity from the Moss Landing generating station, units 6 and 7. PG&E's Request is approved.

By Advice Letter 2803-E filed March 24, 2006

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**SUMMARY**

**AL 2803-E and the tolling agreement with DEMA is approved.**

In Advice Letter (AL) 2803-E PG&E requests the Commission finds the proposed tolling agreement with DEMA for Moss Landing units 6 and 7 for energy and capacity beginning in January 2007 and lasting until December 2010 both reasonable and prudent, for all purposes including PG&E's rate recovery of payments made pursuant to this contract, for the full duration of the contract. The contract is for a total capacity of 1509 MW.

This tolling agreement fits within the confines of PG&E's approved Long Term Procurement Plan (LTPP), and is consistent with the requirements of Commission decisions and with the Energy Action Plan (EAP) Loading Order. D.02-10-062 lists a set of products and transaction types that PG&E may use to fill residual net open position, and D.04-12-048 approved the LTPP containing both Loading Order targets and net short positions. These decisions place a restriction on the sort of contracts into which PG&E can enter; AL 2803-E, filed pursuant to the authority granted under its LTPP, is compliant with all the requirements of the decision and with the approved LTPP; therefore it is approved.

**BACKGROUND**

**The Commission issued D.02-10-062 authorizing the IOUs to re-enter the process of procurement**

In D.02-10-062 we ordered the IOUs to recommence procurement and to facilitate more long term planning. The decision set January 1, 2003 for the recommencement of IOU driven procurement, and for implementation of AB 57.

This decision approved short term procurement plans, but maintained the flexibility for the Commission to create more structure later. It also authorized the IOUs to enter into contracts of less than five years in duration, and authorized a list of procurement products and transactions into which the IOUs can enter. Preparation and approval of LTPPs were left until a later decision.

**D.04-12-048 found reasonable and approved Long Term Procurement Plans (LTPPs) for the 3 IOUs.**

D.04-12-048 extended the procurement authority of IOUs to ten years, and maintained the requirement to consult with the Procurement Review Group (PRG). Specifically the decision found reasonable PG&E's Net Short Position and resource scenarios and found its bottom up approach with respect to the Loading Order to be in compliance. This decision updated and reiterated the findings of D.02-10-062. In closing its net open position, PG&E is restricted to a set of authorized products and types of transactions authorized in its LTPP.

**DEMA issued a Request For Bids for Moss Landing and selected PG&E; PG&E issued RFO9 and chose DEMAs Moss Landing offer**

DEMA issued a Request for Bids (RFB) on August 30, 2005 for purchase of a maximum of 1500 MW of capacity with day-ahead call options from the Moss Landing Plants. The RFB allowed for purchase of the capacity in increments of 375 MW. The RFB was updated on September 8. PG&E submitted indicative bids into the RFB on September 30, 2005 and was notified October 3, 2005 that it had been short listed. On December 8, PG&E issued Request For Offer Number 9 (RFO9) to address needs for intermediate term shapeable energy while continuing negotiations with DEMA. PG&E's RFO9 asked for offers of energy and capacity with a minimum contract term of three years and a minimum size of 25MW. RFO9 also encouraged specific price and heat rate ranges. Eight companies, including DEMA, submitted offers totaling 8000 MW of capacity. On December 28, 2005 PG&E determined that DEMAs offer, relative to the other offers received via RFO9, gave PG&E higher market value.

**Under its LTPP, PG&E has sufficient authority to enter into this agreement without filing an Advice Letter, but some issues in the contract arrangement make it prudent to seek Commission approval**

- The size of this agreement (1509 MW of capacity) represents a significant portion of PG&E's contracted resources.
- This agreement transacts for RA prospectively four years out, although the rules of the program are evolving and the applicability of this product four years from now is not certain.

- Pending sale of the Moss Landing facility will create uncertainty as the counterparty to this agreement will change. In total, PG&E will purchase over 2000 MW of contracted capacity from LS Power.

The PRG was notified regarding the RFO and DEMA's offer on September 30<sup>th</sup>, 2005, December 1<sup>st</sup>, 2005, and January 12<sup>th</sup> of 2006. On February 27<sup>th</sup> PG&E notified the PRG that it intended to move forward with this agreement, and the PRG expressed no concerns.

### **NOTICE**

Notice of PG&E AL 2803-E was made by publication in the Commission's Daily Calendar. PG&E mailed a redacted copy of the Advice Letter and distributed it in accordance with Section III-G of General Order 96-A.

### **PROTEST**

Aglet Consumer Alliance (Aglet) protested AL 2803-E on April 13, 2006 raising three key issues.

1. This contract is beyond the scope of the Advice Letter process. Contracts are usually filed via application, which provides for more rigorous hearing and testimony. Filing this contract via Advice Letter cuts short that review and decides too many issues without public input
2. AL 2803-E requests finding that their purchase of RA four years out was reasonable and prudent. If this was determined, that would constitute a finding that the contract counts towards future RA obligations, when that issue is still unsettled.
3. AL 2803-E requests cost recovery for this contract via Advice Letter, instead of the more appropriate Energy Resource Recovery Account (ERRA) proceeding.

### **PG&E RESPONSE TO PROTEST**

PG&E filed a response April 20 countering each of these three claims. The response counters the three key areas as follows:

#### **1. PG&E has sufficient procurement authority to enter into the proposed tolling agreement**

PG&E has authority granted under D.04-12-048 to execute contracts for less than five years (this contract runs 4 years) without the need to file an application. The Commission has previously approved contracts

less than five years in duration via the AL process (Resolution E-3929 approving a contract with Morro Bay Units 3 and 4)

**2. PG&E acknowledges that rules for Resource Adequacy (RA) are continuing to evolve**

The RA program is evolving and changing, and although PG&E asks for approval of entry into this contract including purchase of RA capacity, there is enough flexibility in the contract to allow the program to evolve further. The contract provides for the possibility of amendments to this contract due to regulatory orders, and assigns oversight to current and future regulatory agencies tasked with administering the RA program. The contract also allows both parties to turn this contract into a standard capacity product once the market for such products evolves. For that reason, PG&E is not asking for upfront approval before the program develops.

**3. PG&E has the authority to request approval to enter into the proposed contract, subject to review by the Commission with respect to the reasonableness of PG&E's administration of the contract.**

D. 02-10-062 states that the current cost recovery mechanism should diminish the need for after the fact reasonableness review and provide for expedited recovery of all procurement costs in order to support the credit of utilities. AL 2803-E asks for a finding that PG&E's actions are reasonable and prudent for all purposes, including rate recovery of all payments made under this contract, for the entire duration of the contract, subject only to Commission oversight as to the reasonableness of PG&E's administration of the contract. This administration oversight and any rate adjustments occur via the ERRA proceeding and not in this AL, and for that reason PG&E is not asking for a change in the review process. This contract is within the scope of the AL process.

**DISCUSSION**

In D.04-12-048 we established a list of specific criteria from which to judge whether a contract is in accordance with the policies and procurement requirements.<sup>1</sup> Specifically PG&E must demonstrate:

1. that there is a residual energy or capacity need to be met with this transaction;

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<sup>1</sup> D.04-12-048, page 154, exempts contracts of five years or less from the requirement to add a GHG adder to all fossil bids.

2. this transaction fits within the EAP Loading Order only after cost effective higher order resources are procured first;
3. that this transaction occurs via approved transaction types, and PG&E is transacting in approved products for approved durations;
4. the RFO was open to all offers and transparent, within the constraints of the product offered;
5. that the product transacted gives the highest ratepayer value compared with alternatives using the Least Cost Best Fit Methodology; and
6. that the RFO, bid valuation, and selection were thoroughly reviewed with the PRG

Finally we also evaluate the specific issues contained in Aglet's protest and PG&E's response to the protest.

### **Residual Energy and Capacity Need**

PG&E demonstrates its residual need via a set of energy and capacity tables required by D.04-12-048. These tables were most recently updated in the LTPP filings of March 2005<sup>2</sup>. The Energy Division has reviewed these tables and determined a net short position in energy and capacity, especially hour ahead dispatchable and shapeable energy that PG&E needs for operational reliability. These needs increase in 2006 and 2007 as current contracts begin to expire. PG&E also needs RA capacity to fill a shortfall that beginning in 2007 is greater than the total purchase proposed here. These shortfalls necessitate and justify PG&E's RFO9.

### **Compliance with the EAP Loading Order**

The EAP Loading Order, published May 8, 2003 and endorsed again in D.04-12-048, contains explicit direction regarding the state's preferences for meeting identified resource needs, and the IOUs are to prioritize their resource selections accordingly."<sup>3</sup> Cost effective procurement of Demand Response (DR), Distributed Generation (DG), and Renewable Energy (RE) are to occur prior to any procurement of fossil resources.

In D.04-12-048 we chose to accept compliance with the EAP by finding that the LTPPs "are EAP-compliant to the extent they include EAP targets established in the RPS, DR and EE proceedings; included, at a minimum, the DG forecasts in the 2003 IEPR, and added transmission and clean central-station generation to meet remaining energy and capacity needs."<sup>4</sup> Chapter 4 of PG&E's LTPP laid out the goals for the growth of DR, DG, and RE in a table alongside projections of need for fossil resources. Chapter 4 discussed the "bottom-up" methodology

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<sup>2</sup> These tables are the most current information available, as these tables are only updated when IOUs update their LTPPs. IOUs are set to update their LTPPs in the middle of 2006.

<sup>3</sup> D.04-12-048, page 31

<sup>4</sup> D.04-12-048, page 45..

that PG&E would use to compute residual need for cost effective fossil generation after all the higher order resources are accounted for and subtracted. In order to protect resource mixes and other commercially sensitive information, we merely say here that this contract does not constitute a departure from the EAP, since it is in line with PG&E's LTPP and fits within the residual net short after preferred higher order resource targets are carved out.

### **Types of Approved Transactions and Products**

D. 02-10-062 lists a set of approved products and transactions, including the terms of this contract. An RFO for energy and capacity is approved. PG&E also has authority to enter into a tolling agreement with duration of under five years.<sup>5</sup>

### **Open and Transparent RFO**

D.04-12-048 requires that RFOs be open to all sources and be conducted transparently and without prejudice towards utility owned generation or counterparty. IOUs have the option however "to tailor their RFOs to reflect their specific resource needs."<sup>6</sup> This RFO for shapeable energy is a type of specific resource need; PG&E would need to show in issuing RFO9, through which DEMA bid Moss Landing units 6 and 7, that there was no restriction other than particular product specifications that encouraged or discouraged particular products from bidding. Of primary concern is bias towards utility owned generation, and bias against renewable or other non-central station fossil fuel.

Part of the determination is made by examination of the specific RFO language , and part is made via survey of the PRG materials presented regarding the RFO and from the general determination of PRG recipients.

The language from the RFO makes clear the exact and precise product being solicited by PG&E. The RFO solicits offers for flexible dispatchable resources with an hour ahead and real time call option and a minimum size of 25 MW. Resources with day ahead and less flexibility were not accepted. A 25 MW minimum offer is warranted due to the magnitude of the needed capacity sought in the RFO. We see it as reasonable that PG&E is trying to more efficiently procure resources, and we find the 25 MW minimum offer to be warranted. .

PG&E has the authority to issue RFO9 for shapeable energy, and within the technical and operational limits of the product, we find that the RFO was open and transparent. Of importance is the nature and quality of the bids. Significantly, no renewable generator bid into this RFO, as well as no one with

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<sup>5</sup> D.02-10-062, page 37-38

<sup>6</sup> D.04-12-048, page 218

dispatchability concerns. Also of note is that PG&E has no affiliates, and the only bids were from truly independent facilities.<sup>7</sup>

### **Highest Value to Ratepayers via Least Cost Best Fit**

D.04-12-048 requires the use of Least Cost - Best Fit (LCBF) methodology<sup>8</sup>. Application of this methodology can be verified via PRG comments and presentations of valuation. PG&E demonstrated via the PRG presentations on January 12, 2006 that DEMA's offer for Moss Landing held the most value. When PG&E added a proxy value for local RA attribute at a level higher than regular system RA, one other offer emerged as higher valued; without a significantly high value for local RA, the other offer was not competitive with DEMA's offer. DEMA's offer also gives PG&E full dispatch rights to the unit including ancillary services.

Backing up this conclusion, Aglet in their protest specifically supported the economics of the agreement and agreed with PG&E that "this agreement is competitively priced relative to market prices."<sup>9</sup>

We are convinced that the methodology has been used adequately here, and that this contract provides positive and maximized value to ratepayers, relative to the other offers in RFO9.

### **Consultation with PRG**

PG&E consulted with the PRG on various occasions through the development and execution of RFO9. PG&E presented needs analysis and bid strategy to the PRG on September 30, 2005; PG&E updated the PRG on December 1 after PG&E had been shortlisted by DEMA; and PG&E discussed the upcoming RFO9. PG&E presented the response to its RFO at the January 12<sup>th</sup> meeting, with valuations and rankings of offers. On February 27<sup>th</sup>, PG&E presented the final arrangements for this offer to the PRG and stated its intention to move forward.

PRG participants are allowed and encouraged to submit support, opposition, or analysis to the Commission via comments during the Advice Letter protest period; since no comments were received, it is assumed that the PRG offered no opposition to the proposed contract with DEMA for Moss Landing units 6 and 7.

### **Discussion of Protest and Response to Protest**

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<sup>7</sup> D.04-12-048, page 217, Finding of Fact No. 84 lifts the ban on dealing with affiliates in RFOs, but requires an Independent Evaluator when affiliates are present in the bids.

<sup>8</sup> D.04-12-048, page 127, orders IOUs to use "Qualitative and quantitative attributes include performance risk, credit risk, price diversity (10 vs. 20 yr. price terms), and operational flexibility etc." when evaluating bids in an all source RFO.

<sup>9</sup> Aglet Protest (April 13, 2006) page 1

Aglet protested AL 2803-E due to concerns over the scope of the AL process, provisions for multi-year RA, and rate recovery. PG&E responded to these concerns, and offered more explanation. We have reviewed Aglet's protest and PG&E's response. We find that the responses to the protest provided by PG&E are persuasive, and reject Aglet's protests.

### *Scope of the Advice Letter Process*

Aglet's protest raised the issue of the scope of the Advice Letter process. D.04-12-048 requires that all contracts of larger than five years be filed via the application process, which allows for public testimony to review PG&E's claims. Filing this contract as an Advice Letter cuts short the review process and hampers public input; there are too many issues to be decided in this agreement that would benefit from public hearing.

We find this unpersuasive, since we have issued no mandate for PG&E to bring this contract to the Commission. We have approved other contracts with a duration of less than five years via the Advice Letter process (e.g. Resolution E-3929); we appreciate the opportunity to review this contract, since the complex nature and significant size of this commitment, as well as the pending asset sale to LS Power warrants the attention that we can provide.

Although doing so here, we are not expecting all contracts of less than five years to be brought to us for approval via advice letter, and we are not altering in any way the other requirements of the Long Term Procurement Proceeding; contracts with duration of over five years must still "be submitted with an application to the Commission for preapproval."<sup>10</sup> We find that this agreement and Advice Letter are within the scope of the Advice Letter process, and deny Aglet's protest.

### *Multi-year RA*

Aglet correctly states that the rules for RA, and in particular multi-year RA, are under development. It is our intention to facilitate and encourage long term planning, and have determined to take up the issue of multi-year RA contracts in Rulemaking 05-12-013. The terms and conditions of AL 2803-E do not dispute our authority to develop RA rules through the RA program, or whatever successor agency manages a future RA program. We believe there is sufficient certainty in this program over the four year term of the agreement to warrant forward contracting for RA capacity, and that AL 2803-E clearly does not ask us to prejudge future policy decisions regarding counting conventions and resource requirements. This contract also sets up a mechanism by which the parties (PG&E and DEMA) meet upon any change in the RA program that materially affects the economics of this agreement to adjust and resettle the agreement.

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<sup>10</sup> D.04-12-048 page 108



We are left with no challenge to our ability to alter and evolve the RA program via approval of this contract. We deny this part of Aglet's protest and accept PG&E's response.

#### *Rate Recovery via ERRA Proceeding*

Aglet protests that in filing this contract and asking for a finding that this contract and PG&E's entrance into it are reasonable and prudent for all purposes including rate recovery, PG&E is asking to circumvent the ERRA Proceeding.

PG&E disagreed with Aglet's protest by reaffirming its intention to track procurement related expenses in a separate account and using the ERRA proceeding to balance that account for purposes of determining future rate recovery. In approving this contract, we would not be allowing PG&E to claim rate recovery outside of the ERRA proceeding, but only that PG&E's entrance into this contract is reasonable and prudent.

We have outlined the process for balancing the ERRA accounts and tracking administration of power procurement contracts, and reaffirm that this process is the correct one for determining rate recovery.<sup>11</sup> PG&E does not disagree. We appreciate the reminder that Aglet provides, but we reject its protest on this point.

#### **PG&E's entrance into this tolling agreement is reasonable and prudent**

Due to the preceding discussion, we are convinced that PG&E's entrance into this tolling agreement is reasonable and prudent for all purposes including rate recovery for the entire duration of the contract. We are satisfied that the specific contracting requirements established in D.02-10-062 and D.04-12-048 are met, and that this contract fits within the restrictions of PG&E's approved LTPP. This agreement represents positive ratepayer value through use of the Least Cost Best Fit methodology.

#### **COMMENTS**

Public Utilities Code section 311(g) (1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g) (2) provides that this 30-day period may be reduced / waived upon the stipulation of all parties in the proceeding.

#### **FINDINGS**

This resolution finds:

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<sup>11</sup> D.02-10-062 pages 62-64

1. On March 24, 2006, PG&E filed AL 2803-E requesting approval of a tolling agreement between DEMA and PG&E for energy and capacity from Moss Landing units 6 and 7.
2. A protest was filed by Aglet on April 13, 2006 stating opposition to this agreement
3. PG&E replied to the protest on April 20, 2006.
4. PG&E has demonstrated sufficient residual need for capacity and shapeable energy that this contract will fulfill.
5. D.04-12-048, by approving the LTPP, also determined that PG&E has satisfied the requirements of the EAP Loading Order. This tolling agreement does not prevent the cost effective procurement of higher order resources; this tolling agreement fits within the residual need after said resources are procured.
6. PG&E can enter into a tolling agreement lasting less than five years for energy and capacity through a public RFO, under authority granted by the Commission.
7. RFO9, for shapeable energy, fulfilled the requirement that the RFO was open to all sources, given the constraints of the product being solicited. .
8. PG&E has demonstrated that the DEMA contract is preferred in terms of economic value via application of the LCBF methodology.
9. PG&E has satisfied D.04-12-048 by consulting with the PRG prior to the RFO and throughout the bidding and contracting process. The PRG has provided useful comment and oversight in the method of valuation and ranking of offers.
10. Although D.04-12-048 does not require PG&E to bring a contract of duration under five years to the Commission for approval, in doing so PG&E does not seek nor is granted a modification of the process
11. We find that although the RA program is developing, there is sufficient structure to allow PG&E to pursue multi-year RA products, given that the agreement specifically realizes our oversight of the eventual counting rules, and our prerogative to change rules as the program evolves.
12. PG&E must use the ERRA proceeding in order to recover in rates the procurement costs related to this contract. AL 2803-E does not seek nor have we granted exception to that rule.

13. The entry of PG&E into this contract is both reasonable and prudent for all purposes of rate recovery during the entire duration of the contract.

**THEREFORE IT IS ORDERED THAT:**

1. The request of PG&E for Commission approval of a tolling agreement between itself and DEMA for capacity and energy from Moss Landing units 6 and 7, to begin January 2007 and expire in December 2010, entitled Master Power Purchase and Sale Agreement, dated March 2, 2006 is approved.
2. PG&E shall track expenses incurred from the operation of this tolling agreement in its ERRA account which shall be subject to Commission jurisdiction via the ERRA proceeding.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on July 20, 2006.

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STEVE LARSON  
Executive Director

June 20, 2006

I. D. #5760  
RESOLUTION E-4002  
Commission Meeting July 20, 2006

TO: PARTIES TO PACIFIC GAS AND ELECTRIC ADVICE LETTER  
NO 2803-E

Enclosed is draft Resolution Number E-4002 of the Energy Division. It will be on the agenda at the next Commission meeting, which is held at least 20 days after the date of this letter. The Commission may then vote on this Resolution or it may postpone a vote until later.

When the Commission votes on a draft Resolution, it may adopt all or part of it as written, amend, modify or set it aside and prepare a different Resolution. Only when the Commission acts does the Resolution become binding on the parties.

Parties may submit comments on the draft Resolution.

An original and two copies of the comments, with a certificate of service, should be submitted to:

Jerry Royer  
Energy Division  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

A copy of the comments should be submitted to:

Donald Brooks  
Energy Division  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102  
Fax: 415-703-2200

Any comments on the draft Resolution must be received by the Energy Division by July 3, 2006. Those submitting comments must serve a copy of their comments on 1) the entire service list attached to the draft Resolution, 2) all Commissioners, and 3) the Director of the Energy Division, on the same date that the comments are submitted to the Energy Division.

Comments shall be limited to five pages in length plus a subject index listing the recommended changes to the draft Resolution, a table of authorities and an appendix setting forth the proposed findings and ordering paragraphs.

Comments shall focus on factual, legal or technical errors in the proposed draft Resolution. Comments that merely reargue positions taken in the advice letter or protests will be accorded no weight and are not to be submitted.

Replies to comments on the draft resolution may be filed (i.e., received by the Energy Division) on July 10, 2006, a week after comments are filed, and shall be limited to identifying misrepresentations of law or fact contained in the comments of other parties. Replies shall not exceed five pages in length, and shall be filed and served as set forth above for comments.

Late submitted comments or replies will not be considered.

Judith Ikle  
Energy Division

Enclosure: Service List

Certificate of Service

**CERTIFICATE OF SERVICE**

I certify that I have by mail this day served a true copy of Draft Resolution E-4002 on all parties in these filings or their attorneys as shown on the attached list.

Dated June 20, 2006 at San Francisco, California.

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*Jerry Royer*

**NOTICE**

Parties should notify the Energy Division, Public Utilities Commission, 505 Van Ness Avenue, Room 4002 San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the Resolution number on the service list on which your name appears.

Service List for Resolution E-4002

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